Report to	Cabinet	**Item**
	12 December 2018	9
Report of	Chief finance officer (Section 151 Officer)	
Subject	Treasury Management Mid-year Review Report 2018/19	

Purpose

This report sets out the Treasury Management performance for the first six months of the financial year to 30 September 2018. This is in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management and Prudential Codes.

Recommendation

To:

1) note the contents of the report, the treasury activity undertaken, and briefing on regulatory updates;

2) approve the amendments to the Council's use of AAA rated money market funds to include AAA rated Constant Net Asset Value Money Market Funds (CNAV) and AAA Low Volatility Money Market Funds (LVNAV) due to money market regulatory changes and note that this change is not expected to change the Council's risk appetite; and

3) note that there are no longer specific recommended treasury management indicators in respect of interest rate exposures and credit risk; and

4) approve the revised maturity structure of borrowing indicator included in this report.

Corporate and service priorities

The report helps to meet the corporate priority of providing value for money services.

Financial implications

The report has no direct financial consequences however it does report on the performance of the Council in managing its borrowing and investment resources during the first half of 2018/19.

Ward/s: All Wards

Cabinet member: Councillor Kendrick - Resources

Contact officers

Karen Watling, chief finance officer	01603 212440
Miriam Adams, senior technical accountant interim	01603 212562

Background documents

None

Report

Background

1. This mid-year report has been prepared in compliance with the CIPFA Code of Practice on Treasury Management and covers interest rate forecasts, a review of the Treasury Management Strategy Statement (TMSS) and Annual Investment Strategy, the latest position on the Council's capital expenditure and Prudential Indicators, a review of the investment portfolio for 2018/19, a review of the Council's borrowing strategy and debt rescheduling in 2018/19 as well as compliance with Treasury and Prudential indicators for 2018/19.

2. The original Treasury Management Strategy (TMS) and Prudential Indicators were reported to and approved by Council on 20 February 2018.

3. This Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector and operates its treasury management service in compliance with this Code. This requires that the prime objective of treasury management activity is the effective management of risk, and that borrowing activities are undertaken on a prudent, affordable and sustainable basis.

4. CIPFA issued a revised Prudential Code (which governs local authority capital expenditure) and a revised Treasury Management Code (which governs local authority borrowings, investment, cashflow and risk decisions). Both of the revised codes are in response to developments arising from the Localism Act 2011, namely the fact that councils are using the general power of competence to engage in increased commercial activity. These updated codes became effective from 1 April 2018.

5. As part of the key changes to the 2017 Prudential Code, authorities are required to breakdown their borrowing in excess of 'ten years' into several ranges if significant borrowing is held in these periods, when setting the maturity structure of borrowing indicator. Where in-year revisions are made for periods within 24 months, the time periods will take reference from the start of the financial year. This now applies to both fixed and variable rate borrowing.

6. There is no longer a specific recommended indicator in respect of interest rate exposures, instead authorities are asked to explain their strategy for managing interest rate risks as part of their capital /investment strategy while the management and exposure of interest rates will be part of its treasury management strategy. Authorities are encouraged to set a liability benchmark which measures the projected debt requirement plus a short term liquidity allowance for future periods.

7. Authorised limit must relate to borrowing on the authority's own single entity balance sheet where it has interests in companies. However, authorities must have regard to its financial commitments and obligations when deciding if borrowing is affordable.

8. There is a requirement to produce a capital strategy to strengthen governance and increase transparency over non-treasury related investments, such as commercial property acquisition and lending to third parties.

9. Alongside this, the Ministry for Housing, Communities and Local Government (MHCLG) has updated the Statutory Guidance on Local Government Investments and revised Guidance on Minimum Revenue Provision effective from 1 April 2018. Key changes have been included in para 43 to 46 of this document.

10. However due to the late issuing the updated Codes and the investment guidance (February 2018), both CIPFA and MHCLG recognised that it may not prove practical or cost effective to incorporate the changes into the 2018-19 Strategy, so instead must include the requirements and disclosures in full in the first Strategy presented to full Council or equivalent after 1 April 2018.

11. This was the case for Norwich City Council. The proposed changes to the capital strategy along with the other changes within the TMS and investment strategy will be developed for approval by Council as part of the 2019/20 budget cycle.

Investment Strategy

12. The TMSS for 2018/19, which includes the Annual Investment Strategy, was approved by the council on 20 February 2018. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

13. No policy changes have been made to the investment strategy, the Council will continue to aim to achieve the optimum return (yield) on investments commensurate with proper levels of security and liquidity.

14. The Council held £57.8m of investments as at 30 September 2018. Table 1 below shows the movement in investments for the first six months of the year.

Table 1

Investments	**Actual 31 March 2018**	**Investments**	**Maturities**	**Actual 30 September 2018**
	£'000	**£'000**	**£'000**	**£'000**
Short term				-
Banks	8,000	4,000	(5,000)	7,000
Building Societies	12,000	6,000	(11,000)	7,000
Local Authorities	3,000	3,000	(6,000)	-
Cash Equivalents				-
Banks	6,770	495,200	(488,170)	13,800
Building Societies	1,650	88,170	(86,820)	3,000
Local Authorities	4,250	37,000	(29,250)	12,000
Money Market Funds	15,000	-	-	15,000
Total	**50,670**	**633,370**	**(626,240)**	**57,800**

15. It is anticipated that cash balances will decrease during the second half of the year to come as they will be used to temporarily fund commercial property acquisitions already in the pipeline and an approved additional loan to Norwich Regeneration Limited (NRL).

16. The corresponding loss of investment income is more than compensated by the net income returns generated by these schemes. The Council continues to undertake appropriate due diligence in the selection of its commercial properties as well as scrutiny of its lending to NRL.

17. The Chief finance officer confirms that all investment transactions undertaken during the first six months of 2018/19 were within the approved limits as laid out in the Annual Investment Strategy.

BALANCE SHEET POSITION

External Borrowing

18. Table 2 below shows the Council has actual external borrowing of £201.617m, most of which relates the Housing Revenue Account (HRA). There has been no new borrowing to date in this financial year.

Table 2

Borrowing Long Term	**TMSS**	**Actual 30-Sep-18**	**Estimate 31-Mar-19**
	£'000	**£'000**	**£'000**
Public Works Loan Board	294,973	196,107	194,107
Money Market	5,000	5,000	5,000
3% Stock (Perpetually irredeemable)	499	499	499
Corporate Bonds and External Mortgages	74	11	11
Total	**300,546**	**201,617**	**199,617**

Forward borrowing considerations to mitigate expected future interest rate increases

19. The Council may look to arrange forward borrowing facilities should the future borrowing risk rise or predictions of a significant rate rise is expected. This would enable the Council to lock into borrowing facilities at current low rates and draw down the cash over a period of up to 3 years subject to cashflow demands. It should be noted that some of these facilities may carry brokerage and arrangement fees that will be factored into value for money assessments.

Debt Rescheduling

20. No debt rescheduling was undertaken during the first six months of 2018/19. It is not anticipated that the Council will undertake any rescheduling activity during the remainder of the financial year. However, should borrowing rates fall significantly as a result of Brexit, the Council may consider borrowing to

finance its unfinanced borrowing need as well as rescheduling some of its existing debt if this proves cost effective.

21. Table 3 below shows the interest rate forecast to March 2022.

Table 3

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5 Year PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10 Year PWLB Rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25 Year PWLB Rate	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50 Year PWLB Rate	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

Source: Link Treasury (PWLB rates include adjustments for Certainty rate discounts)

Impact of Brexit on future economic forecasts

22. Current economic forecasts predict Gross Domestic Product (GDP) growth to remain below 2.0% between now and 2021, while the Consumer Price Index (CPI) measure of inflation is currently outpacing that at 2.5% but is expected to fall to 2.00% by 2021. The Bank of England bank rate is forecast to rise to 1.75% by 2021. A peak forecast for 10 year gilt rates, upon which PWLB borrowing rates are based, is currently forecast at 2.0% by 2020. These forecasts are subject to a number of significant risks, the primary of which is the impact a no deal Brexit position for the UK, which could mean tighter monetary policy.

Prudential Indicators

23. This part of the report is structured to provide an update on:

- The changes to the Council's capital expenditure plans;
- How these plans are being financed;
- The impact of changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing.

Capital Expenditure

24. Table 4 below shows the 2018/19 original and revised capital programme. A detailed breakdown of capital programme schemes can be found in the capital budget monitoring report.

Table 4

	2018/19 Original	2018/19 Revised
	£'000	**£'000**
General Fund	42,792	38,322
HRA	31,572	30,086
Capital Expenditure	74,365	68,408
Financed by:		
Capital receipts	5,221	6,571
Capital grant and contributions	3,265	6,272
Capital reserves	0	0
Major Repairs Reserve	14,238	14,739
Revenue	11,641	11,944
Total Resources	34,365	39,526
Net borrowing need for the year	**40,000**	**28,882**

25. The forecast outturn of the 2018/19 General Fund and HRA capital programme reported above is as at period 7.

Financing of the Capital Programme

26. The table in paragraph 25 above shows how the revised capital programme will be financed and shows that the net borrowing need for the year has decreased from that anticipated when Council approved the TMS due to scheme slippage. The consequence of this is a decrease in the Council's forecast Capital Financing Requirement (CFR) for 2018/19 as shown in the table below.

27. The principal changes in the financing from the original estimates approved in February 2018 are the reduction in the expenditure forecast thereby reducing estimated borrowing forecast.

The Capital Financing Requirement

28. Table 5 below shows the Councils CFR, which is the underlying external need to borrow for a capital purpose. The second table compares the original and revised forecast debt position against the CFR, the difference representing an under borrowing position. This under borrowed position means the capital borrowing need (the CFR) has not been fully funded with loan debt. Instead cash in hand supporting the Council's reserves, balances, and expenditure has been used as an alternative temporary measure. This strategy is prudent in the current economic climate - as returns achievable from the investment of cash are lower than the cost of raising additional loan debt, and counterparty risk remains elevated – but this will need to be reversed over time when the original requirement for that cash arrives.

Table 5

	2018/19 Original Estimate	2018/19 Revised Estimate
	£'000	**£'000**
General Fund CFR	133,555	87,401
HRA CFR	185,602	205,717
Total CFR	319,157	293,118
Movement in CFR	37,559	28,483
Movement in CFR represented by:		
Borrowing need for the year	40,000	28,882
Less MRP and other financing adj.	(441)	(298)
Less Leasing MRP		101
Movement in CFR	37,559	28,483

	2018/19 Original Estimate	2018/19 Revised Estimate
	£'000	**£'000**
Gross borrowing	302,050	200,518
CFR	319,157	293,118
Over/(Under) Borrowing	(17,107)	(92,600)

Prudential Indicators relating to Borrowing Activity

29. **Authorised Limit** – This represents the legal limit beyond which borrowing is prohibited, and needs to be set and revised by Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. The limit represents the CFR (assumed fully funded by borrowing) plus a margin to accommodate any unplanned adverse cashflow movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The authorised limit has not been breached and no external borrowing has taken place so far this year.

Table 6

	2018/19
Authorised Limit for external debt	**£'000**
Borrowing	335,000
Other long term liabilities	1,600
Total	336,600

30. **Operational Boundary** – This indicator is based on the probable external debt during the course of the year; it is set deliberately lower than the authorised limit. This limit acts as an early warning indicator should borrowing be approaching the Authorised Limit. This limit may be breached on occasion under normal circumstances, but sustained or regular breaches should trigger a review of borrowing levels. The operational boundary has not been breached and no external borrowing has taken place so far this this.

Table 7

	2018/19
Operational boundary for external debt	**£'000**
Borrowing	315,000
Other long term liabilities	1,600
Total	316,600

Borrowing Activity

31. The uncertainty over future of Brexit and its impact on interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

32. Long-term fixed interest rates are currently low but are expected to rise over the five year treasury management planning period. The Chief Finance Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates or opportunities at the time, taking into account the associated risks e.g. counterparty risk, cost of carry and impact on the Medium Term Financial Strategy as well as risk of interest rate increases.

33. Opportunities for debt restructuring will be continually monitored alongside interest rate forecasts. Action will be taken when the Chief Finance Officer feels it is most advantageous.

Investment Performance

34. The objectives of the Councils investment strategy are firstly the safeguarding of the repayment of the principal and interest of its investments, and secondly ensuring adequate liquidity. The investment returns being a third objective, consummate to achieving the first two.

35. The Council held £57.800m of financial investments at 30th September 2018 and the investment profile is shown in the table in paragraph 14 above.

Risk Benchmarking

36. The Investment Strategy for 2018/19 includes the following benchmarks for liquidity and security.

37. Liquidity – The Council has no formal overdraft facility and seeks to maintain liquid short-term deposits of at least £1 million available with a week's notice.

38. Average return on investment at 30 September 2018 was 0.67% against a 7 Day LIBID benchmark average rate of 0.59%. The weighted time to maturity

(WAM) of investments was 30 days compared to 103 days on 30 September 2017. The decrease in WAM duration was mainly due to uncertainty on commercial property acquisition timing and the need to hold more cash liquid as a result. At 30 September 2018 the Council held £57.8m of cash balances, all of which are invested for periods of less than 364 days. The increase in return has been mainly due to the increase in Bank of England bank rate in August 2018.

39. The Chief Finance Officer can report that liquidity arrangements were adequate during the year to date.

40. Security – The weighted average credit risk of the portfolio at the end of the period was 3.43% (5.53% September 2017). The Council's maximum security risk benchmark for the portfolio as at 30 September 2018 was 0.007%, which equates to a potential loss of £4k on an investment portfolio of £57.8m.

41. This credit risk indicator is lower than the anticipated maximum risk of 0.041% in the Treasury Management Strategy. At 30 September 2018, 100% of the investment portfolio was held in low risk specified investments.

42. The Chief Finance Officer can report that the investment portfolio was maintained within this overall benchmark during the year to date.

REGULATORY UPDATE

Proposed Changes to in the new MRP Guidance issued by MHCLG

43. The Council is required to approve **an MRP Statement** in advance of each year. Council approved the 2018/19 revised MRP guidance in July 2018.

44. MHCLG in February 2018 issued MRP Guidance under S21A of the Local Government Act 2003.

45. The new Guidance sets out that no MRP will be charged in respect of loans to other bodies for capital expenditure purpose. However, the capital receipts generated by the annual repayments on these loans will be put aside to repay debt and MRP will be charged in years where there is no repayment.

46. The Guidance also requires a local authority to fully provide for debt taken on to acquire an asset classified as an investment property. Such assets should not be subject to depreciation.

Proposed Changes to IFRS9 Accounting Standard

47. This accounting standard came into effect from 1 April 2018. The key change is the removal of the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact on to the Surplus or Deficit on the Provision of Services, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but other types of investments like pooled investment vehicles,

third party loans, commercial investments are likely to be impacted. These changes however will not impact on the budget position of the council.

48. The impact on the council's current portfolio of treasury managed investments at 30 September 2018 is summarised in table 8 below.

Table 8

Treasury Investments as at 30 September 2018	**Impact of IFRS9**
Fixed deposit investments in banks and building societies	Amortised cost – however credit rating default tables will be applied.
Fixed deposit investment in other local authorities	Amortised cost – no impact on budget
Money Market Funds • Constant net asset value money market fund • Low volatility net asset value money market fund	Amortised cost – no impact on budget
Call and notice accounts	Amortised cost – however credit rating default tables will be applied

Proposed Changes to IFRS16 Leases and likely implications for the Local Authority Accounting Code

49. Although the standard was issued in January 2016, authorities are expected to comply from 1 April 2019 (though consideration is being made to postpone this for one year). The current classification of leases into operating and finance will no longer apply with the exceptions of leases of 12 months or less and leases of low value. This change will therefore impact the Council's CFR, but have no borrowing impact. A lot will depend on the evaluation of contracts and their implications.

Proposed Money Market Fund Regulatory Changes

50. The Money Market Fund sector is now at the last stages of introducing new regulations which will affect the various types of money market funds. The regulatory change which will take effect from 1 January 2019 will now see existing non-government Constant Net Asset Value (CNAV) - which the Council currently invests in - convert to Low Volatility Net Asset Value (LVNAV) pricing. The reason for the change in classification is that constant (of CNAV) implies no risk to capital invested, when in reality if placed under extreme stress the fund may have to pass losses to clients. The new category of LVNAV explicitly sets out that, although the funds continue to operate in the same manner as before, there is a minor low-exposure to volatility. There is no impact on the Council as this change does not represent taking on additional risk.

51. All money market fund managers servicing the local authority market have stated that their funds will be converting to Low Volatility Net Asset Value (LVNAV) MMFs.

52. This change will occur in the very early stages of 2019; as such this is an update to the current TMS to incorporate the use of LVNAV funds. The Cabinet is asked to approve the use of both CNAV and LVNAV funds.

Update on Ring Fencing of UK Banks

53. From 1 January 2019, the largest UK banks must separate core retail banking from investment banking. This is known as ring-fencing. Ring-fencing was the central recommendation of the Independent Commission on Banking. The key aim of the separation is to improve the resilience and resolvability of banks by changing their structure. Simpler activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-today core transactions, whilst more complex and riskier activities are required to be housed in a separate entity, a non-ring-fenced bank (NRFB). While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered) will be considered for investment purposes.

Abolition of HRA debt cap

54. In October 2018, the Prime Minister announced a policy change of abolition of the HRA debt cap. Although no further detail on potential changes to reporting have been issued to date, this change has significant impact on the Council's HRA and its strategy on house building.

Integrated impact assessment

The IIA should assess **the impact of the recommendation** being made by the report
Detailed guidance to help with the completion of the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Cabinet
Committee date:	12/12/18
Director / Head of service	Karen Watling
Report subject:	Treasury Management Strategy Statement and Annual Investment Strategy Mid-year Review Report 2018/19
Date assessed:	03/12/2018
Description:	This is a mid-year report to inform council on the performance of the treasury management activity for the first 6 months of the year and it includes updates on Prudential Code, MHCLG Minimum Repayment Provision and MGCLG Investment Guidance.

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The prudential indicators show that for the first 6 months of the year treasury management activity has produced positive results e.g. achieving an investment interest rate above the target.
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**

	Impact			
Risk management	☐	☒	☐	Managing risk is a major part of undertaking the treasury management activity. All the indicators and limits put in place to reduce the level of risk have been adhered to thus reducing the risks to an acceptable level as stated in the Treasury Management Strategy.

Recommendations from impact assessment
Positive
Negative
Neutral
Issues

Current Maturity Structure of Borrowing

Maturity structure of fixed interest rate borrowing 2018/19		
	Lower	**Upper**
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	30%
5 years to 10 years	0%	50%
10 years and above	0%	95%

Revised Maturity Structure of Borrowing

Maturity structure of fixed interest rate borrowing 2018/19		
	Lower	**Upper**
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	40%
5 years to 10 years	0%	70%
10 years and above	0%	70%

APPENDIX B

Revision to time and monetary limits applying to the Council's investments

2018/19 Treasury Management Strategy Statement - Table 10

	Fitch Long term Rating (or equivalent)	**Money Limit**	**Time Limit**
Banks 1 higher quality	AA	£15m	364 days
Banks 1 lower quality	AA	£5m	364 days
Banks 2 – part nationalised	N/A	£15m	3 years
Limit 3 category – council's banker (if doesn't meet Banks 1 criteria)	A-	£5m	3 months
Building Societies	Asset worth at least £2bn	£10m	364 days
DMADF	AAA	Unlimited	6 months
Local authorities (LA)	N/A	£10m per LA	5 years
Constant Net Asset Value Money Market Funds (CNAV) Low Volatility Money Market Funds (LVNAV)	AAA	£5m per fund £25m overall limit	Liquid
CCLA Local Authorities' Property Fund		£10m	Minimum of 5 years